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UniCredit S.p.A. (UNCRY) Q2 2024 Earnings Call Transcript

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Q2: 2024-07-24 Earnings Summary

EPS of $0.87 beats by $0.05 | Revenue of $6.86B (3.60% Y/Y) beats by $293.44M

UniCredit S.p.A. (OTCPK:UNCRY) Q2 2024 Results Conference Call July 24, 2024 4:00 AM ET

Company Participants

Magda Palczynska - Head of Investor Relations
Andrea Orcel - Chief Executive Officer
Stefano Porro - Chief Financial Officer

Conference Call Participants

Andrea Filtri - Mediobanca
Ignacio Cerezo - UBS
Ignacio Ulargui - Paribas Exane
Chris Hallam - Goldman Sachs
Britta Schmidt - Autonomous Research
Delphine Lee - JPMorgan
Azzurra Guelfi - Citi
Pamela Zuluaga - Morgan Stanley
Marco Nicolai - Jefferies

Operator

Good morning, ladies and gentlemen. Before I hand over to Magda Palczynska, Head of Investor Relations, a reminder that today's call is being recorded. Madam, you may begin.

Magda Palczynska

Good morning, and welcome to UniCredit's Second Quarter and First Half 2024 Results Conference Call. Andrea Orcel, our CEO, will take you through the results. This will be followed by a Q&A session with Andrea and Stefano Porro, our CFO. [Operator Instructions]. With that, I hand over to Andrea.

Andrea Orcel

Good morning, and thank you for joining us today. It is with great pleasure that we announce our second quarter and first half 2024 results. This mark the historic achievement for UniCredit in its journey to set a new benchmark for banking, 14 consecutive quarters of profitable growth, delivering a record quarter and a record first half. These results are a testament to the unwavering commitment of our team with disciplined execution of our long-term vision and strategy and our dedication to creating value for all our stakeholders over time.

The track record we have built in the last 3.5 years is undeniable. We are confident that our action will further propel our positive performance in the future, setting UniCredit to part as an attractive investment opportunity.

We have delivered consistently outstanding results across all KPIs: growth, profitability, efficiency and distributions outpacing our peers. These achievements are down to clarity of direction, disciplined execution and the proactive steps we take to prepare for the future. UniCredit has transformed into a blue-chip bank with value still to unlock, lots of it. One defined by both resiliency and profitable growth. Resiliency through the cycle, leveraging our lines of defense and maintaining a quality-driven approach.

Profitable growth through quality earnings and excellence in operational and capital efficiency all propelling our best-in-class distributions.

Our past is marked by transformation. Our present by superior sustainable performance. Our future by our continuing to unlock significant potential. This performance is down to our mindset. It is the essence of how we engage with our clients and how we do business.

This is the 14th consecutive quarter of quality growth, driven by our focus on profitable NII, increased fees and improved operational and capital efficiency, all leading to superior return on tangible equity and organic capital generation to support best-in-class distribution.

Given the backdrop of rates and pass-through normalization, the profitable growth in gross NII of 5% in the half and 2% in the quarter is impressive. Overall, cost of risk remained well below our target at 5 basis points for the half and 1 basis points for the quarter, thanks to continued significant write-backs again, underscoring the conservativeness of our provisioning policy. As such, net NII dynamics mirrored those of gross NII. Our fee income grew 6.6% in the half and an impressive 10% in the quarter, thanks to our investments in people, fees in people and with fee-to-revenues reaching 33% and 34%, respectively.

Our focus on operational efficiency, while investing, and capital efficiency, while targeting profitable growth, continue to set the standard for the industry. Absolute costs declined by 1.2% over the 6 months and 1.7% accelerating in the quarter. With our cost-to-income ratio further improving to 36.3%, 2.9 percentage points better than a year ago. Our net revenue to RWAs reached 9.1% in the quarter, up 1 percentage point from a year ago. RWAs were further reduced to €277 billion.

It is the combined performance across all these levers but allowed us to reach a record return on tangible equity of 13% CET1 of circa 23.5%, 20% reported for both the half and the quarter, a record organic capital generation of €6.7 billion or 234 basis points for the half, supporting accrued distribution of €5.25 billion or 100% of net profit, while increasing our CET1 ratio to 16.2.

A net profit growth of 20% for the half and 16% for the quarter. In the half, our EPS increased by 36%, our accrued EPS by 53% and our tangible book per share by 20%. These results are built on strong foundation across leading capital levels, sound asset quality and strong liquidity ratio.

Let's now look at the P&L in further detail. Let's start with net revenues. Net revenues increased 7% to €12.6 billion in the half and 6% to €6.3 billion in the quarter. This is a result of a resilient, best-in-class NII, well above the cost of equity, a top-tier fee to revenue ratio with strong upside potential, a structurally lower and less volatile loan loss provision and continued solid trading.

NII, net of provision play the critical role in our P&L., and we have focused on keeping it well above our cost of equity and resilient. We now have a RoAC above 20% in the quarter in NII. While this number will normalize on the back of lower rates and higher cost of risk, we have laid the foundation for value-accretive growth thereafter, always exceeding our cost of equity. Gross NII and margins are slightly down quarter-on-quarter as rates have started reducing.

Pass-through has continued to increase, loan volumes have now recovered, and we focus on profitability. Strong management of the pass-through with an increase of only 1.4 percentage points to 31.5%, driven mainly by Germany with a skew to corporates and Central Europe, driven by Austria. Italy pass-through increased by less than 1 percentage point. Deposit volume stabilized Q-on-Q. We have continued to improve our lending mix as we move towards higher profitability and crossover segments.

Those that bring us both corporate and retail clients with significantly diversified needs. Asset quality. Our NPE ratio has improved quarter-on-quarter, and we remain well covered. Our overlays to protect the future remain outsized and higher than the industry. The decline from 1.8% to 1.7% is a rounding equal to €25 million. Our overall cost of risk remains low, reflecting where we are in the cycle and benefiting from substantial write-backs.

We witnessed continued significant write-backs across our entire franchise. Germany cost of risk run rate increased year-over-year as it may be earlier in the cost of recycle. Italy is broadly stable versus a year ago, while Central Europe, Eastern Europe and Russia saw significant net reversal in the half.

Conservative past provisioning, leading to very significant write-backs enabled Russia to absorb half of the impact of a single name legal provision in risk and charges. As such, it may be interesting for you to consider our cost of risk together with single NIM risk and charges, which would raise the 1 basis point for the quarter to circa 19 basis points.

Cost of risk, excluding Russia, was 12 basis points. For the half, broadly in line year-over-year and 11 basis points for the quarter, up 5 basis points year-over-year. We reaffirm our guidance of a cost of risk below or well below 20 basis points for the year, as we still plan for the start of the normalization of the cost of risk cycle and potential further precautionary provision in the second half. This is just a precaution at this point.

Fees. Fees increased 7% in the half and 10% in the quarter as a result of our investments in product factories and renewed client appetite. These were propelled by clients rebalancing their portfolio ahead of the expected rate normalization and benefited from the renegotiation of some contracts in asset management and in payments. While we remain confident in our fee growth prospects and this strong cash should not be annualized.

We have taken a measured and disciplined approach to further streamline our organization through the redesign and automation of processes and reducing bureaucracy. Our €1.1 billion of integration costs charged last year is allowing us to maintain our efficiency leadership while investing. Costs declined 1.2% in the half and 1.7%, therefore, accelerating in the quarter, with cost to income further improving to 36.3%. Our continued focus on operational efficiency has allowed us to invest in people, hiring, training, attractively rewarding and retaining our talent. And in our business, enhancing our product factories and digital capabilities.

We intend to continue this investment whilst keeping the like-for-like cost base broadly flat going forward.

Our best-in-class organic capital generation of €6.7 billion in the half and €3.3 billion in the quarter has allowed us to accrue 100% of net profit for distribution while increasing CET1 to 16.2% versus 15.7% like-for-like 1 year ago. Our disciplined focus on quality net revenue growth ensuring a net NII RoAC above cost of equity and an increasing ratio of fee to revenues, complemented by an obsessive focus on operational and capital efficiency of a key to maximizing profitability and organic capital generation while growing, maintaining best-in-class ordinary distribution without denting capital. This is a competitive advantage that will guide us going forward as we strive to support excellent ordinary distribution without denting CET1. Excess capital deployment will be additive to that.

As we look at our regions and product factories, I would remind you of the differentiated strengths and value add that each of these bring to the overall group. UniCredit is much more than the sum of its part.

Italy. Our Italian business had another excellent quarter, demonstrating its ability to deliver sustained quality profitable growth and outstanding returns well above peers. Net revenue rose 5.5% to €5.6 billion in the half and 3.7% in the quarter. NII was up 8% in the half and 3.3% in the quarter, thanks to strict management of the pass-through and continued rebalancing in our lending mix.

Cost of risk remained mild at 28 basis points for the half and 23 basis points for the quarter, also benefiting from continued write-backs. Fees were up 7% in the half and 10% in the quarter, with all of our factories contributing but with particular strength in investments, in protection, in payments and in corporate finance. Italy is growing its assets under management and gaining market share in bank insurance and to a lesser extent in certificates as our advisory activity supports customer deploy additional investment in the right products. Hence, we have a greater impact from volume than from margin given certificate higher margins and upfronts. But we believe that this is the right strategy at this moment and will pay dividends in the future.

Cost rose 0.6% in the half and 0.3% in the quarter, a structural savings from continued simplification and streamlining offset most of the inflation and investment in the business growth, including 550 new hires in the network and 350,000 hours of training to our people. RWAs were reduced by €12 billion or 10% half-on-half. Italy further strengthen its operating and capital efficiency with its best-ever 33.9% cost-income ratio and 10.6% net revenue to RWA. Profit before tax rose 16% to €3.4 billion in the half and 14% to €1.8 billion in the quarter. RoAC reached 32% in the half and 33% in the quarter.

Italy generated €3 billion of organic capital in the half. Germany. Germany's profitability is the best in a decade, supported by excellent operational efficiency. Net revenue fell 3.6% to €2.7 billion in the half and 2.6% in the quarter. Germany quarterly NII would have been flat, adjusting for the impact of higher funding costs of our group trading portfolio, which was driven by higher volume. Overall, NII was down 10% in the half and 11% in the quarter.

Being predominantly a corporate bank with a pass-through level on deposit near to 50%, Germany future sensitivity to rate normalization is fairly low.

Cost of risk remained more elevated than the trend line at circa 20 basis points as our franchise is more sensitive to single name files and the country may or may not be earlier in the credit cycle. Fees were down 1% in the half, but up 3% in the quarter as performance accelerated across all categories, especially in investment, plus 18%, payment, plus 5%, nearly offsetting the lower client hedging fees compared to previous year's extremely high client demand.

Germany had the most scope in rationalizing its corporate center and continues to do so. Costs were reduced 7 percentage points in the half and 6% in the quarter while continuing to fund investments. RWAs were reduced by €7 billion in Germany or 9% half-over-half. Germany continued to improve its operating and capital efficiency with a 39.2% cost-income ratio and 8% net revenue to RWA setting records. Pretax rose 18% to €1.6 billion in the half and 12% to €740 million in the quarter.

RoAC remained at or above 20% for both the half and the quarter. Germany delivered €1.4 billion of organic capital generation in the half.

Central Europe. Central Europe's profitability continues to be driven by strong revenue and disciplined cost control. Net revenue rose 5.5% to €2.2 billion in the half, but were down 0.8% in the quarter. NII was up 5.9% in the half and 1.4% in the quarter despite a downward trend but is expected to accelerated due to lower rates and higher pass-through. Cost of risk had net reversal of 5 basis points in the half and loan losses of 9 basis points in the quarter.

Fees were up 11.5% in the half and 13% in the quarter, thanks to strong investment in Austria and a large advisory mandate in the Czech Republic. Business initiative across all segments should support this trend.

Going forward, revenues will be more visibly impacted by the downward trend of interest rates, partially offset by strong contribution from fees performance. Costs grew by only 1.8% in the half due to wage drift, partially compensated by efficiency activities, enabling us to also continue investment in digitalization. RWAs were reduced to €1.2 billion -- by €1.2 billion or 2% in the half. The disciplined focus on operating and capital efficiency continued across all countries reflected in a 36.5% cost-to-income ratio and 7.4% net revenue on RWA ratio. Pretax rose 17% to €1.3 billion and 1% at €700 million in the quarter. RoAC was 24.3% in the half and accelerated to 26.2% in the quarter, and the region delivered €1.3 billion of capital organically in the half.

Eastern Europe, outstanding profitability continued at pace this quarter, driven by excellent revenues and strong operational efficiency. Net revenues rose 21% to €1.5 billion in the half, increasing 26% in the quarter. NII was up 17% in the half and 12% in the quarter. Thanks to strong business growth across the region, a favorable rate environment and good pass-through control. Cost of risk, a net reversal of 59 basis points in the half due to continued write-back and a profitable NPE disposal and underscoring once more the conservativeness of our provisioning. Cost of fees were up 13% in the half, 14% in the quarter, driven by all categories.

Going forward, revenue is expected to remain broadly stable despite a downward trend in interest rates, thanks to strong commercial activity, focused on profitable and capital-efficient business. Costs grew 3.4% in the half, offsetting most of the region, high inflation, whilst we continue to invest in our people and in digitalization. Our focus on operating and capital efficiency was reflected in a 30.3% cost-to-income ratio and 10.2% net revenue on RWA ratio in the half. Pretax grew 32% to €1 billion in the half and 35% to more than €550 million in the quarter. RoAC exceeded 40% in both half and quarter with a region delivering €600 million of capital organically in the half.

Client Solutions. Turning to our product factory. Strong performance across the board. Client Solutions revenue grew by 7% in the half to €5.8 billion, 2/3 of which is fees. Corporate Solutions revenues rose by 4% to €2.7 billion in the half, driven by advisory and financing up 9%.

Payment Solutions rose by 6% to €1.3 billion, driven by payments, up 14%. Individual Solutions rose by 13% to €1.7 billion, driven by investment up 17%. Onemarkets grew to €8 billion in AUM, confirming our business proposition.

Our transformation from laggard to leader is due to the consistent delivery across all metrics, regions and products. We have moved from a bank languishing in the bottom quadrant to one in the top quartile, defined by quality revenues, profitability, organic capital generation and distribution metrics, consistently outperforming our core peers for 9 consecutive quarters.

Our disciplined focus on quality profitable growth over volumes naturally constrained our net revenue and net profit growth versus peer with a greater volume focus. Regardless, we move close to leadership position in both cases. Our strategy aims to excel in net revenue over RWA, organic capital generation, which ultimately supports distribution, cost-to-income ratio and return on tangible equity. Here, we move to and retain clear leadership outperforming all peers. We have significant further room to add value, and you will see that going forward.

Moving to tomorrow. Today, we're a completely different bank, one that has demonstrated its ability to consistently deliver. Our remarkable performance has propelled our total shareholder return and market cap rose to the top of the sector, while we continue to invest in the future, and we have just begun. We will build on this momentum, continue to deliver accretive profitable high-quality growth over volume, underpinning best-in-class distribution, outperformed our benchmarks and ultimately secure a valuation that truly reflects our worth.

We're not just prepared for the future, we're shaping it. We have the resilience, the flexibility and the ability to adjust to extenuating circumstances without impacting our overall performance, and this quarter is not an exception. Our people and our winning culture will unlock even greater value in the future.

Our commitment to our stakeholder remains unchanged. We aim to become the bank for Europe's future, empowering communities to progress and setting a new benchmark for banking. This is the guiding star that unites and inspire us all at UniCredit. We shall continue to strive for the best outcome for our 3 stakeholders. By putting our clients and community at the very heart of everything we do, we are transforming our organization from the ground up.

Our client success is our success and their satisfaction is our ultimate reward. Our people represent the true value of UniCredit. We empower them, invest in them and foster an environment where they can thrive. Their dedication and passion are the driving forces behind our achievements, and we are committed to supporting them. Our investors provide us with the financial resources to achieve our objectives, and we are committed to protect their interest and deliver the highest sustainable returns and distribution to reward them.

Our profitability and distribution yields are the best in the peer group, achieved without compromising our capital, asset quality and liquidity strengths. The vision and this commitment will not change. Our strategy also remains unchanged, specifically designed to play to our strengths and address our weaknesses. It is composed of a set of levers which we can flex depending on the needs of the business, the growth opportunities and the external environment. It is the combination of those levers that allows us to evolve over time, while being consistent to our vision and objectives.

We have put our clients back at the center that has shaped a new business model. We have progressively redesigned our organization turning in on inside, we have redesigned our processes, way of working, aiming to achieve excellence in efficiency, leveraging our scale in technology, in data, in operation, in procurement, in training and in product offering to deliver with speed and quality.

We are uniting and empowering our people around one vision, one winning culture, one set of principle and value, and we are supporting them with the right organization and tools. We're developing best-in-class product factories, alone or with strategic partners, to deliver the best financial services, product to 15 million clients across Europe by increasingly integrated distribution channel freely selected by our clients. We're investing in best-in-class technology and data, evolving our operation to continue to secure efficiency while enhancing our clients and on people experiences.

Our strategy is underpinned by clear financial targets, delivered through an optimal balance of our 3 financial levers. Given the changed environment and our ongoing transformation, we have shifted or are shifting our focus to quality top line growth while maintaining leadership in asset quality, in capital and in operational expense. To grow our top line in a quality way, once freight and cost of risk normalize, we will continue to tilt the mix of our lending towards high net NII RoAC products and segments while fulfilling our clients' broader needs. This will also drive fee growth, supported by investment in our people, in our factories, in our distribution channels and in our technology. Doing so, we will maximize our capital efficiency, enhance capital generation and profitability, powered by our improvement in operational excellence.

Our dedicated approach to quality over volume and our proactive buildup of lines of defense result in a uniquely resilient bottom line and confidence in our long-term outlook.

Given headwinds, this result could have been expected to go in the opposite direction, they didn't. Our cost of risk is defined by quality focus and a conservative approach, and we have still €1.7 billion overlays to further support our cost of risk. In cost, we continue our obsession with efficiency, holding €1.5 billion of buffers already sustained from nonoperating items last year.

In capital, we focus on optimal capital allocation and a superior profitability portfolio mix with €6.5 billion of excess capital, protecting total distribution and/or allowing for strategic flexibility to further propel net profit through inorganic and now with Vodeno-Aion organic external growth. Our task now is to maintain our leadership across all these levers. But our new focus is to be in a unique position on NII as our approach gives us a very high quality and profitable top line whose growth is now the central focus of our strategy. Without changing strategy, we now shift our focus from the operating machine to the commercial machine. Our commitment to quality over volume and our diversified footprint have resulted in NII growth that aligns with our European peers. But with net NII RoAC, having grown by 3x and its resilience enhanced by the shift in our lending mix.

Our future in fees looks bright, given the momentum and the further impact of our past and planned investment and internalization. The combination of the higher resilience of NII and above-market growth of fees gives us confidence on the future top line trajectory. The strong foundation, proven track record and diversified levers to generate fee-based growth above market rates uniquely position us for the future.

Vodeno-Aion. Through our investment in Vodeno-Aion, UniCredit acquires. Firstly, Vodeno's next-generation cloud-based core banking technology, fully competitive with best-in-class providers such as [food machine] [indiscernible] Scalable and flexible offering a comprehensive suite of digital banking products across multiple channels. We are welcoming 200 technology engineers, developers and data scientists as well as a management team with a strong track record in banking and technology implementation.

Through Aion, we acquired a small bank incorporated in Belgium, whose legacy technology and clients have already been successfully migrated to Vodeno, and that already operate through a branch structure in Poland, Germany and Sweden. It is the combination of Vodeno and Aion that provides them with a competitive advantage vis-a-vis pure technology providers and fintechs. This investment propels UniCredit into a new realm of technology development and digital banking, ensuring a strong differentiation from pure technology providers, neobanks and incumbents undergoing digital transformation.

Going forward, UniCredit will be able to leverage Vodeno's technology and talent to further develop this now proprietary technology and use it as a sandbox for a number of technology innovations. We can use Aion to profitably and quickly enter targeted client segments for entire markets across Europe, providing additional opportunities to deploy our excess capital. This is our third route. Vodeno and Aion will continue to target embedded finance services to marketplaces, e-commerce retailers, travel, health care and education platform and banking as a service to -- for selected fintechs.

We aim to start with a project on Poland, considering the significant level of synergies with our other European markets and the credibility and experience of the Vodeno and Aion management team in the area. We will come back to you with further detail once the project is fully fledged. We're investing €370 million in cash for 100% of Vodeno, Aion with an expected impact on our CET1 of circa 15 basis points. The P&L impact of the consolidation will be dependent on the level and speed of additional investment that we made to develop this technology and these franchises, and we will communicate it to you in due course. We expect to close by year-end, subject to regulatory approval.

I may add, we have no intention of integrating Vodeno-Aion. They will be like our 14th bank providing us with selective technology and organic growth opportunity through start-ups in various markets and marketplaces.

I will now provide you with an update on Russia. Our strategy has been clear since day 1, working towards an ordinarily solvent, wind down as quickly as possible, always without both the letter and the spirit of a complex legal, regulatory and sanction limitation. At each and every step we have held true to our values, determined to do right by our principles and reputation, even if capitulating to pressure would have been the easier pass at the time. We remained determined not to take action, but by breaching local laws and regulation provide Russia with a justified motive to intervene and take control of our local asset and the value that comes with it.

Facts speak to themselves. We have significantly reduced our activity since the first quarter of '22, particularly those not related to Western companies. Cross-border exposure is down 93% from €4.5 billion to €300 million, while minimizing our loss to 11% of principal. Local loans are down 68% from €7.3 billion to €2.3 billion. Local deposits are down 69% from €8.3 billion to €2.6 billion.

And cross-border payments are down 56% from €25 billion to €11.2 billion. I remind that as all of our economies continue to purchase selective materials from Russia, those materials go through the payment system of 3 banks. In doing so, we have also absorbed the drag on our growth and profitability. And more importantly, we reduced the capital impact of a full write-down of Russia from circa 130 basis points on a 14% CET1 to circa 50 basis points on a 16.2% CET1, transforming it from very significant to non-substantial.

Looking ahead, our ultimate goal is clear and unwavering, and we believe fully consistent with the expectation of our regulator. We will continue to drive down our exposure to Russia, and are continuing as we speak. Our existing plan foresees the following targets for 2025. Cross-border exposure, practically 0, with 100% reduction. Local loans below €1 billion with an 85% reduction.

Local deposits, below €2 billion with in excess of 75% reduction. Cross-border payment to €8.5 billion, with more than a 66% reduction.

Recently, we were advised by the straightforward implementation of recent instruction by the ECB may be inconsistent with our legal framework in certain area or conflicting with other duties. Given the seriousness of the potential consequences involved, we have sought legal clarity from the European Court of Justice to protect UniCredit from unnecessary risks, including potentially providing Russia with a justified motive to intervene and take control of our local asset and the value that comes with them. We welcome the ECB's recent openness to further clarify the request, have of any ruling and remain open to withdraw our request to the ECJ, should their clarification provide us with a necessary legal comfort. Should it be necessary for the proceeding to continue, we consider an institutional win any ECJ ruling regardless of the outcome as we would have confirmed the legality of the past, we have been ordered and the rule of law in all of our actions.

Let's move to guidance. The strong start to the year allows us to increase our net revenue guidance to over €23 billion from circa €22.5 billion. This is thanks to the strong performance across all revenue lines and higher expectation for the full year skewed more towards net interest income. Our operational and capital efficiency results are also ahead of plan as we have front-loaded a number of initiatives.

We have chosen not to upgrade our net profit and return on tangible guidance at this time as we retain flexibility to further support our future performance as we have done every year. However, I want to be clear, putting aside that flexibility, our underlying performance is sent to substantially exceed or in other words, blow out our net profit and return on tangible guidance. This is the same conservative approach we have taken so far. Our 2025 and 2026 ambition remains steady and confirm. We are well positioned to continue our trajectory of sustainable profitable growth and outsized distribution.

And if this -- and it is the sustainability of high growth and high profitability and high distribution that provides the value of UniCredit.

In conclusion, we have again demonstrated the effectiveness of our UniCredit unlock strategy. Our metrics of growth, efficiency, capital generation, profitability and distribution set a benchmark for our industry. We have moved from a restructuring story to a blue-chip bank with superior growth and distribution prospects. We face the future with the same strategy shifting our emphasis from our efficiency KPIs, which we shall defend, to our top line quality growth KPIs.

We have leading profitability and distribution, strong line of defense and more than €6.5 billion of excess capital that protect or further propels our profitability and distribution depending on the opportunity. We have plenty of runway and are excited to show what we can do when rates and cost of risk normalize. The team has demonstrated again and again their ability to come through, and they continue to surprise even me. I would not want to bet against them. Both our price to earnings and price to distribution multiples remains at a substantial discount to not only top peers but also to the broader sector, particularly when considering our fundamentals and the comfort provided by our line of defense and excess capital. We offer a unique investment opportunity at an attractive entry point.

Thank you all, and we shall open for questions.

Question-and-Answer Session

Operator

[Operator Instructions] The first question is from Andrea Filtri of Mediobanca.

Andrea Filtri

I wonder if you could please reiterate your NII income guidance without Russia. And as just said, you have built a very large implied net profit cushion. Should we then read the implied cushion in your net profit guidance as the eventual actions that could come or Russia later on and that are unforeseeable at the moment or it is more to smoothen year-on-year profitability '24 and '25 and '26.

Andrea Orcel

I will start, and Stefano will finish. So our NII guidance has been increased to in excess of €23 billion. Our fee guidance for the moment is remaining the same. We have been proven wrong in as much as this was the same thing we told you in the first quarter when we thought that the jump in fees could not be replicated in the second quarter. It was actually not only replicated, it jumped further up with an acceleration.

We are cautious. This is part of the culture of this organization in replicating that in the second year because a number of these movements are due to clients going ahead of the expected normalization of rates and rebalancing their portfolio. So when this rebalancing will finish and what comes next is now speculation.

So we think it is the prudent things to do to not double the first half into a second one in terms of fee. Therefore, we keep it unchanged with, I would say, an upside risk. Which goes back to the cushion, more than the cushion, I would refer you to what we did in '21, to what we did in '22, to what we did in '23. We have a tendency to exceed our guidance, and we have a tendency to also put down the foundation to continue to grow from what becomes then a pretty high bar. And at this point in time, the right thing to do is to tell you, we are going to be above €8.5 billion.

We are going to beat the 16.5% return on tangible equity. We are going to beat on cost, but how much is premature, because we would like to use some of that, as you called it, cushion, to potentially further propel the profitability that is already quite ambitious for '25, '26 and beyond.

So it's not a -- there is a cushion. It's very difficult for us to tell you what is the number. What the numbers that we can give you, but maybe not number, but direction we can give you, is that if I take away what you call a cushion, the underlying is obviously marching well above €8.5 billion and well above 16.5%. With respect to Russia, we continue to compress the franchise there. And we have had a number of legal cases like everybody else.

This one is, just to be clear, has -- is the last one in terms of guarantees that we provided over the last significant ones.

And again, we are not sure of the outcome. The outcome could be, a, that we get hit; b, but legally, we have claim on the clients we guaranteed it is premature to tell you that. So -- but for the time being, Russia has demonstrated that it had significant buffers without touching our overall overlays to absorb the shock. So Russia is not driving what we're saying about net profit and return on tangible equity.

Stefano Porro

Andrea just add a few points to what Andrea just said, in relation to the guidance for net revenues and fees is including Russia. Having said that, the contribution of fees is not material. If you go beyond 2024, we are dealing with center-like below €100 million, while as we have stated more than once, especially starting from second part of this year, but also '25, the reduction of net interest income in Russia will be a few hundreds million.

Operator

The next question is from Ignacio Cerezo of UBS.

Ignacio Cerezo

I've got two on NII. One is, if you can share your views a little bit actually. I know it is a combination of several geographies. But if you can give us a little bit of color in terms of the pass-through levels you're expecting on lending and deposits as rates starts compounding, and any geographical color basically would be helpful. And specifically on this, I mean, we're seeing deposit cost in Germany, and I'm guessing Austria still going up, obviously, I mean, that might become a tailwind when rates start going down.

So the question is how quickly do you think you can reprice your deposits in those 2 countries to start protecting the net interest income as rate start going down.

Stefano Porro

So in relation to deposit pass-through, the group is at 31.5%. The split by countries is the following.

We are at 15.5% in Italy. We are at 28% in Eastern Europe, and we are above 46% in both Germany and Central Europe, including Austria. In terms of trend we saw in the quarter an increase of around 1% in Italy and Eastern Europe and around 3% up in Germany and Central Europe.

Now if you look all in all, the deposit cost, the deposit costs didn't move up so much. So we are dealing with a few basis points when you're looking at the absolute amount.

The composition is there is very different because in Italy, we have a 95% side deposit, while take, for example, Germany or Central Europe, we have 55% and 60%, respectively. That means that the reduction of the Euribor and the connected repricing will happen especially in Germany and in Austria. How long does it take? I mean, it will be already in the second part of the year, consider that the average maturity of term deposit is a range between 3 months and 5 months. So taking that in consideration with a slight delay, we will have repricing down.

So what we can expect in overall cost of deposit, absolute rate at year end, below the level of second quarter.

Andrea Orcel

I think I would like to add that if you look at our franchises, Italy and Eastern Europe are balanced between retail and corporate. Germany and Central Europe are predominantly corporate. So the sensitivity is very different in the 3 blocks, if you call them this way. So Germany and Central Europe benefit much less and are much more sensitive going up because they reprice quickly. Hence, the pass-through that is so high.

But when it goes down, they also can reprice faster because there is more scope to reprice on the deposit side. So I think the group altogether is quite balanced. But if you took those two, they behave differently from the other two.

Operator

The next question is from Ignacio Ulargui of the Paribas Exane.

Ignacio Ulargui

I just have one question, which is on the translation of organic capital generation into distributions. And then how should we expect the improved guidance of organic capital generation into distributions into 2024?

Andrea Orcel

For the time being, if you remember, we said that our distribution policy is set on 2 things, more than 90% -- for normal distribution -- sorry, for ordinary distribution, let me rephrase. For ordinary distribution, at least 90% of net profit, and secondly, not exceeding our organic capital generation because we think that, that is the prudent things to do for ordinary. What we do with strongly, i.e., the excess capital is on top and separate. And to date, we have never used our excess capital to pay our distribution. We have actually accumulated more of it.

So I would say that the distribution for the end of the year will be consistent with those metrics and therefore, depending on where we land in terms of net profit and organic capital generation, we will act accordingly on the ordinary side. On the nonordinary side, i.e., the excess capital that is a judgment call, and we have told you that between '24 and '27, we will either deploy it or return it in full. We also told you that this year, we're targeting €8.6 billion of distributions based on the metrics that I just gave you of net profit and organic capital generation and that we feel that we can repeat that or exceed it in '25, in '26 -- and in '26. And we stay firm on those numbers.

As of today, we have accrued 100% of our net profit, so not 90%, 100%, €5.25 billion, but 60% of the €8.6 billion we wanted to distribute. And obviously, we've done that with an organic capital generation that exceeds that. That's why our CET1 has moved up year-on-year or has moved up since the end of the year where we were at 15.9%. So that is consistent. We're not moving.

Operator

The next question is from Chris Hallam of Goldman Sachs.

Chris Hallam

So 2 for me. First, on NII, you talked about using that technology platform, I suppose, is an avenue to enter new market segments. So there's obviously a revenue opportunity there. But does getting that capability inside the group also make you think at all about touching your own core. I know you've been a bit reluctant in the past to take that step.

But are there things you'd be able to do to the UniCredit systems now inside the group that perhaps you were a bit -- were a bit too difficult to do previously? And then second, clearly, is running well ahead of where you target it in the medium term? And if we take the commentary around flattish costs over the next couple of years as well as what we can see rates and fees, does it feel like that level of profitability needed to reset significantly lower. So if we think about the financial guardrails of any potential acquisition, could that greater than 15% RoTE hurdle rate be adjusted higher if your view on the medium-term returns for UniCredit turns more constructive, i.e., does better organic performance today raise the bar on what you look for in potential deals tomorrow?

Andrea Orcel

So Chris, let me take in reverse order. I think I'm already criticized enough to be to discipline on M&A. If you want to increase my hurdle rate, you will have to deal with a lot of people. But that said, we think we can beat now seriously the 15% over a cycle. And it is clear that when we look and when we are accountable to our shareholders, we look at the returns -- the risk returns of buying back our own stock versus what we get through acquisitions, and we take a balanced view.

It is also true that if you continue to buy your own stock and never grow, we are growing at the moment, but never grow through in organic growth, at one point, you stop growing. And therefore, we're not there. We are actually quite far from there, but we always balance these things. So I would say that we remain constructive on M&A, but we remain very disciplined on M&A.

And more than the hurdle rates, I would say that with normalization of rates and provisions, we believe that not everyone has done the hard work in terms of taking integration costs on to improve their efficiency in terms of building overlays, in terms of investing in technology, in terms of a lot of things. And therefore, if profit -- if that comes through in the numbers, and valuation align or diverge in a positive fashion, then M&A will be more possible.

With respect to more generally Vodeno and Aion, first thing, that I would say is the biggest mistake we could make is to integrate Vodeno and Aion. There would be nothing left. We are a phenomenal bank, but we are also a large monster. They are an agile speed boat and they should remain this way, and we will respect that. It will, however, give us a proprietary technology that has successfully transitioned a legacy bank, small one, to a new set of technology and to a new core.

At this point in time, we do not expect to touch our core, too difficult, too complex and too many banks involved. We are only continuing internally to pursue our strategy and our plan to evolve all the aspects of our technology and our data and make it a competitive advantage, and we are confident we can do that. We expect to Vodeno, Aion, it is what I have said it is.

We now have a proprietary cutting-edge technology, cloud-based for core banking. We also have a very flexible product suite with the ability to add new products on that core banking technology very cheaply. And together with Aion, that allows us to credibly and I underline profitably, enter -- so it's not a revenue gain, it's a profitability gain, to enter new market and be credible when we say this is a return on investment of more than 15% over the next 3 to 5 years. Something we would not have been able to do with the main bank.

So as I said, consider it as 14 banks with a lot of greenfield startup opportunity but can further drive our growth. And combined with 200 engineers who have been extremely successful in building a cutting-edge technology that will allow us to not only trade that technology, not only to sell it as a service to fintech and other smaller banks, but also most importantly, challenge and help us drive improvement into our own bank, but not integrated in it, separate from it.

Operator

The next question is from Britta Schmidt of Autonomous Research.

Britta Schmidt

The first one is coming back to your net revenue guide which has been upgraded by €1 billion while keeping the cost of risk flat and more so as point to not really changing the fee guidance. If we were to take that further less, that means that there's a €1 billion at net interest income outlook and the overall that the second half could be closer, if not match the first half? And the second question is on the cost guidance. Cost guidance flat [ex] perimeter changes. Could you give us an update how you expect the closing of the Romania acquisition and the insurance bank.

Andrea Orcel

So -- and let me start with the second one, and then I'll pass it to Stefano. So on the cost guidance, what we have said at the end of last year is that, and I underline that, in spite of inflation, wage drift and a determination to keep our level of investments, we could commit to keep our cost flat on the perimeter that existed obviously from 2023 to 2026. Now broadly flat, flat. So that guidance has not changed. As you will notice, we're well ahead of our guidance as of today because we're not broadly flat.

We're down 1.2% and accelerated to down 1.7% in the quarter. So our cost control at the moment is excellent, and I'm very satisfied with it. And we haven't touched our investments. So where we're going to go at the moment, we're still guiding for broadly flat to 2026 on the numbers we had in 2023. Whether we do better than that, it's too early to say.

We are in the second quarter of the year. It is premature. And the only reason why we say experiment changes, it's obvious. Vodeno and Aion comes in, if we have significant growth opportunities, and we decided to take them we are going to adjust everything, but it will be with a return on investment overall in excess of 15%. We cannot guess all of that at the moment.

With respect to the net revenue guidance, I would say the following. We are prudent. I would say that our net revenue guidance has upside risk. It has upside risk on net NII because while we haven't changed the guidance of cost of risk from below 20 basis points, below 20 basis points does not mean 19. Below 20 basis points mean below 20 basis points. 0 is below 20 basis points, 10 is below 20 basis points, 15 is below 20 basis points. We haven't updated it because, again, it is premature to give you a number that we can stand solid on it and beat, and therefore, we will probably update that by the third quarter.

If you take our fees, as we said, we are well ahead of our trend line. But there are too many positive wins that are propelling that, rebalancing our portfolios, upfront fees, renegotiation of certain contracts, for us to tell you what is the underlying sustainable trend line for that. But if you take those numbers, they are significantly ahead. And thirdly, if you take NII even without the cost of risk, the reduction is significantly less than what we expected.

So what we are doing at the moment is to tell you, look, it would be superficial for us to give you a new number without having more time to observe the trends and more solidity to back that number. But if you ask me what is the direction of travel today, of course, we are well ahead of what our guidance is today.

Stefano Porro

Timing in relation to perimeter changes that can affect cost. Second half '24 is Alpha in Romania, and Vodeno, Aion, as we discussed before, while for insurance perimeter changes in Italy is first half 2025.

Operator

The next question is from Delphine Lee of JPMorgan.

Delphine Lee

So my first question is going back to the net interest income. I just wanted to see if you could give us some color around 2025. I mean your NII has increased only 65%, as you mentioned on the slide and deposit pass-through is higher in Germany, Austria, just trying to think about how resilient that can be going forward as a result? And how quickly -- I mean what assumption can we use for '25, '26 in deposit pass-through for Germany and Austria, given it's at 46% right now? My second question is on cost.

Andrea, you mentioned in the past, more cost savings potential for the headquarters. I just wanted to check whether that -- this is already covered by the restructuring charges you booked in 2023 or so far? Or should we expect more restructuring charges to be booked by the end of this year?

Andrea Orcel

So I'll start and Stefano will give more precision. Let me start with cost. So what we're doing in cost is fully consistent to what we have been doing for the last 3 years. The fact that it came in the press was to clarify a number of perceptions, but we are executing as we had planned to execute year after year. So when we talk about, we will keep our cost broadly flat to the exit of 2023, notwithstanding which drift inflation and investment.

I assure you we need to pedal very hard to do that. I don't think that there are many banks that are going to be capable to do that, especially coming from 2 years of uninterrupted decrease of cost quarter after quarter, while most of the industry has gone up. So we can do it, but it is hard. And at the moment, I would just say that we're just executing on what we're doing.

If we find further opportunity to go beyond what we have promised, i.e., broadly flat to the end of '22, 2023, if we find them, and it's becoming harder because it requires much more granular organization redesign, process redesign, automation, improvement of a number of things in technology. But if we find them, and there is a justified return, but like everything else needs to exceed 15% by us taking integration cost, like we have taken them in '23 and '22 and '21 in the fourth quarter, we will consider to do that. And I think it's the right thing to do to then further propel '25 and '26 and '27.

With respect to more generally on NII and everything else, I would just open with 2 things. The first thing, while we start from Italy, where a pan-European bank, why is that important? Because our NII sensitivity is way more aligned with European banks than it is with Italians. We -- Italians have been over 100% sensitivity. We've been around 50%, like Europeans.

But if you are less sensitive on the way up, you're also less sensitive on the way down. And that's why I think some of the numbers that you're seeing are more resilient than we all thought they would be. The second thing is countries like Germany or Central Europe, have benefited a lot less than 50% from the rising rates. But at the same time, they will reprice and they will suffer a lot less from the decline in rates. So what you see of UniCredit is a bring to bear of all of these things together.

And it is a little bit too early to say how it's going, but for the time being, our NII is being more resilient. Now let's never forget two things that where we are in the trend of -- in the level of rates. And I don't know what you forecast. But if you're looking at an exit of 2.25, 2.5 and a pass-through that will normalize, the hurdle that we all need to fight against is quite high.

I would finish with one last thing because we insist on it because we think it's very important, maybe not everybody finds it important. The profitability as NII as a line item, so of lending as a line item is often overlooked. And we looked at the overall profitability. But if a bank has 60%, 70%, 80%, 75% of NII, and is actually subsidizing the rest of the business by going below the cost of equity or by not maximizing the profitability of NII by going on volume. I could get you higher NII in terms of volume, you will see declining return on tangible, reclining organic capital generation, declining distribution over time.

We're not doing that. But that also means that we have drawn less than others or than what we could have done and that puts us in a more resilient position than others.

The final thing is we've discussed it many times, the lending mix, which is another thing you should all consider. We started with a lending mix that was secured from a risk standpoint, but with a return on that lending that was way subpar. We have moved that mix. What have we done? For example, in Italy, we have deemphasized mortgages.

We have pushed on consumer. We've pushed on SMEs. Obviously, that means that your volumes are growing less because mortgages, large corporates are large volumes. SMEs, consumer are small volume.

However, you're shifting your portfolio to something a lot more resilient and where margins are much higher. We've been doing that for 2 years, and we're doing it this year. And when we exit, we hope that the renewed growth now no longer net of what we're not doing on the large volumes item and the profitability will emerge in our P&L. So all of these pieces are getting organized to try and minimize the impact of our net revenues because we recognize that while we have the other lines positive, like cost, like cost of risk, et cetera, et cetera, we cannot compensate only with those lines, what will happen when rates normalize and cost of risk normalize, which is why we all are looking forward to the challenge and the competition of how we deal with that versus the sector.

Stefano Porro

So adding some data points, sensitivities. Solid sensitivities in relation to interest income are confirmed. So the interest rate-related one, plus minus 25 basis points at €140 million. And you can also expect such a sensitivity to be slightly lower during the course of '25 as highlighted by Andrea. The deposit pass-through sensitivity, 1 percentage point confirmed at €130 million.

With regards to Germany and Austria, I mentioned before, let's say, the deposit pass-through either ratio between the client rate and the short-term interbank rate that is around 46 basis points. Let's translate that into basis point number. So in Germany, the cost of our deposit is slightly below 200 basis points. In Italy, it's close to 60 basis points. This makes the difference.

So that's why the repricing possibility that we have in Germany and also Austria are higher.

Now you need to look with a pinch of salt in relation to the deposit pass-through because when the rates will go down, technically speaking, the deposit pass-through will go up, right? And then after a while, we will reprice down. This will be especially important for Germany and Austria because of the term deposit component, it will be less likely by definition to something like that in Italy because, as commented, we are already close to 60 basis points. So there is not much room to repricing down. In relation to Germany and Austria, as I told you, we are expecting to have a level of cost for the deposit lower, in the case of Germany, lower than 190, the deposit pass-through expected for '25, it will be slightly higher because there will be a part of the deposit that we cannot reprice and as a cost of that, the deposit pass-through is slightly higher.

But having said that, the overall interest expenses on deposits that we will have in Germany and Austria '25 will be definitely lower.

Operator

The next question is from Azzurra Guelfi of Citi.

Azzurra Guelfi

Looking to your point about that you when talking about the NII and the profitability of NII. Can you give us an idea of how much of your current book is still in -- if you want to be low average profitability? And what are the categories that you see that it could reverse earlier when the rates normalize? And the second one is on the asset quality. You have said that the guidance is below 20 basis points, that would be significantly below 20 basis points, if I understand well, between the lines.

And when I look to the actual data, actually shows that the NPLs are decreasing quarter-on-quarter, in particularly on the unlikely to pay. And also, when I look at Stage 2 and Stage 1, there has been some migration and improvement of the quality. So the underlying data feeds to suggest that the situation is still quite benign. If you can give us some color on what are the trends there, that would be great.

Andrea Orcel

So thank you, Azzurra. So as you have seen, our NII profitability all the way down, so also net of provision is about 20% at the moment or is in excess. We still have about 20% of our book that has still not migrated to above cost of equity. We started with the large majority of our book. We have about 20% of our book that has not migrated.

So in the next, I would say, 18 months we will never get to 100%. It's just not feasible, but we will finish that migration, and we'll have a book that is a lot higher profitability, a lot more resilient, and we will not have the grind that we have experienced from obviously many times exiting lending position that were not meeting our hurdle. With rest to asset quality. I would just say that it's premature to say how much below 20 basis points we're going to land. You are correct.

Our NPEs have improved, both gross and net our coverage has improved, and we are having a positive stage migration again and write-backs as we have kept being prudent in the way we were provisioning. So there is a point where even if you have provision for caution, if your clients repays you, you get back the provisions.

So I think we are, at the moment, experiencing that positive trend. So the only thing on asset quality, in my opinion, is the issue that at some point, all of these write-backs will finish because we will continue to provision conservatively. But I think in the past, we were way more worried about the future, and we provisioned a lot, and this little by little are coming back, but we will be more orderly. At the same time, we have less necessity to be cautious because of the quality of our portfolio and because we still carry I think, well over €1.7 billion of overlays. That's what it is, therefore, to avoid us having bad surprises or to release it if bad surprises don't come.

Maybe Stefano wants to add?

Stefano Porro

Yes, in relation to the trends of the movement of Stage 2 position, we had improvement fundamentally in all the countries. So in Italy, Germany, Central Europe and Eastern Europe in relation to the percentage, I would mention, Italy and Germany. So the Stage 2 percentage out of the total book now is 8% in Italy, slightly above 10%, is between 10% and 11% in Germany.

Operator

The next question is from Pamela Zuluaga of Morgan Stanley.

Pamela Zuluaga

I have a few follow-ups actually. You have been, as you say, writing back some provisions mostly in Eastern Europe, but the overlay is still at a significant €1.7 billion. Can you remind us what is the deadline for the use of release of these overlays? And then when exactly do you expect to see that flat normalization in the cost of risk? The other follow-up is on your net profit comments.

I know we've talked about this, but just trying to get a little bit more color. You say you don't want to continue raising the bar of the net profit to maintain some flexibility. Could this flexibility relate to any further restructuring charges from your plans to reorganize the corporate center or anything else?

Andrea Orcel

So we -- so overlays in inverted commas, "Don't have a hard deadline. What they have is a causality." You take an overlay over a specific potential risk. We took quite a few on COVID. We've then took quite a few on the geopolitical situation with secondary effect from the invasion of Ukraine, et cetera, et cetera. So they have a cause.

So you say, fundamentally, my models are backward looking. They are great, but there are certain aspects of forward-looking but are not fully captured by our models, let's be cautionary -- let's use caution and create some provision in case the effect. Once that item does not occur or it's clear that it's not occurring, you need to release the overlays.

Obviously, the item occurs, you release the overlays. So either you release the overlays because the item occur and you're covering it, or you release the overlay because the item does not occur, and then it propels your returns. What we have been doing over the last 3 years, not because necessarily proactively, but just because of the volatility and the uncertainty of the future is every time a causality of an overlay led to release, and in most cases, it was a release without the risk occurring. There were other reasons why we should create new overlays. And therefore, we have pushed in time, the overlay.

So consider it this way, we had plenty of overlays for COVID. When the impact from COVID did not occur. Well, for example, Russian invaded Ukraine and we had other risk, and we move those -- that causality into a new causality, but now it's kind of stabilizing. So in the next, I would say -- I don't think, for the time being, but hopefully, I'm not proven wrong, but I don't think for the time being that the second half of this year will lead to a significant release of overlays. That means that we have €1.7 billion that should be released between '25 and '26 in my opinion.

It's quite difficult to see with a stabilizing environment that we can carry them anywhere further. So either potential worries occur, and we will have the buffer, or the potential worries do not occur, and we will have a propelling effect by abating our cost of risk, and it will go into the bottom line. That's why we call it a line of defense that can protect or propel.

With respect to transformation, as we said, we are a transformed bank. We've done a lot. I think we're about -- we're more than halfway through. There we continue to challenge everything that we do, how we do it, to see if we can do it more efficiently, more effectively better. We continue to challenge what we do in terms of investing in our product factories, in our frontline, in our distribution channel, in our branches, both physical and nonphysical.

We're now going to get to challenge what we can do organically to grow with Aion and Vodeno. So as we go through that process and I think what is right, what is impressive is the culture of UniCredit that keeps on challenging what we do and seeing if we can do it better. We find new things that we said, why didn't I think about this earlier. We should change it, we should improve it. And when we found those new things, we obviously need to invest into making the improvement, either it's an investment in, I don't know, writing-off some old technology and implementing new one, or it is about prevention some people and hire some more young people, or it is about preempting the investment in launching a new digital bank or whatever it is.

When we have those things, we do, do the broad category of integration cost. We usually culminate in that thinking at the end of the year just because we -- it's difficult to do it while we're flying. And therefore, if you go back and you look, we have done integration cost in '21, we have done integration cost in '22. We have done integration cost in '23. As we became better and better anticipating and investing to push the bank further.

We are working hard on seeing whatever levers and whatever things we can find. And if we find them, we will take some integration cost. There is one commitment that does not move. We will make more than €8.5 billion net profit. And we will make at least a 16.5% return on tangible.

And we will distribute at least €8.6 billion. So we will not put these things at risk.

But the magnitude of the beat because beat there will be is determined by how much we are going to be able to support and continue growing in '25, '26 and '27. And part of that is taking certain charges or making some investment or doing things that are all included in the integration cost line.

Operator

The next question is from Marco Nicolai of Jefferies.

Marco Nicolai

Do you expect any impact from the ECB force to increase provisioning levels on the leveraged loan at UniCredit? So this is the first question. And the second one is you increased the organic capital generation guidance, you left them changed the net income guidance. My question is, shall we read into this more synergies in terms of risk-weighted assets reduction?

Andrea Orcel

So I'll start with the second one. No. It is -- so the organic capital generation is not chemistry. The organic capital generation is where do you grow. How profitably do you grow?

So for example, if tomorrow -- the more we increase the mix in our revenues to fees, the more organic capital generation increases because fees do not require capital. So it's net profit that goes directly to the bottom line. With fees doing that well, implicitly, our organic capital generation increases. Secondly -- the second point which I keep on hammering is the profitability of NII, not the volume of NII, the profitability of NII. If my profitability of NII increases while I am using capital, I am generating a lot more than my profitability of NII decreases.

You're looking at the profitability of our NII is increasing. And therefore, the combination of an NII that maybe in volume, you see the same volume or decline in volume, and you say, well, it's the same. No, it's not the same because if for the same volume I have a more profitable NII, I'm generating a lot more capital. So more capital with profitability of NII, more capital with fees. That is improving the healthiness of our organic capital generation and profitability.

At the same time, in certain cases, for example, to increase the profitability of NII, we are exiting loans that are, let's say, subpar in terms of profitability. In that case, the exit of loan releases capital because we're no longer lending. We lose the revenue, but we are disproportionately impacting positively the capital. So this trajectory continues to bring home results. What I have said before is that there is a point where the entire organic capital generation is going to be linked to the quality of a net profit and no longer to the exit of subpar loans because we will be at optimal and that will happen somewhere in the next 18 months.

So organic capital generation, we have will trend line and then stop at a hopefully small discount to the net profit we do in the year. But I do think that -- so can there be more RWA reductions in the second part of the year? Yes, because we continue to grind through nonprofitable exposures. And we're doing everything we can to take this year all the things that we need to take in terms of efficiency. So when Basel IV rolls in next year, we start from a higher capital level as we possibly can. I'll leave the rest to Stefano?

Stefano Porro

Yes. So interaction with ECB on the leveraged loan topic are still ongoing. Having said that, as always, we do, the cost of risk advance below 20 is including all the relevant formation, so including, let's say, our assessment in relation to this specific topic. With regards to organic capital generation, on top of what Andrea just said, consider what we have done in first half, right? So in the first half, we've done 234 basis points.

So if you are looking the first half and then the expectation of profitability on one hand and other capital efficiency action that we are expecting to do was appropriate for us to move up the organic capital generation guidance above 350.

Operator

Gentleman, that was the last question. Back to you for any closing remarks you may have.

Andrea Orcel

Thank you very much for your time, and see you all in the road show and interaction in the next few days. Thank you, and have a nice break.

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